

UDC 336.74:339.9(045)

GOLIUK V.Y.,
Ph.D. in Economics, Associate professor
of Management Department of the National Technical University of Ukraine
“Igor Sikorsky Kyiv Polytechnic Institute”

MONETARY COMPONENT OF BREXIT IMPACT ON EU AND THE UK ECONOMY

Annotation. *The aim of the paper is to study Brexit impact on economic growth of the UK and EU focusing on its monetary component. The results show, that Brexit will hurt the UK economy much more than economy of European Union. The UK monetary authorities keep monetary policy unchanged waiting for the decision on the Brexit final scenario, while European Central Bank continues its quantitative easing programme, that has already brought gains for European economy.*

Key words: *Brexit, United Kingdom, European Union, economic growth, inflation, monetary policy.*

Голоук В.Я., к.е.н., доцент кафедри менеджменту Національного технічного університету України «Київський політехнічний інститут імені Ігоря Сікорського»

МОНЕТАРНА СКЛАДОВА ВПЛИВУ БРЕКСИТУ НА ЕКОНОМІКУ ЄС ТА ВЕЛИКОБРИТАНІЇ

Анотація. *Метою статті є вивчення впливу Брекситу на економічне зростання Великобританії та ЄС з акцентом на його монетарну складову. Результати досліджень демонструють, що Брексит завдасть значно більшої шкоди економіці Великобританії, ніж економіці Європейського Союзу. Монетарна влада Великої Британії все ще чекає рішення щодо остаточного сценарію Брекситу, залишаючи грошову політику незмінною, тоді як Європейський центральний банк продовжує програму кількісного пом'якшення, яка вже принесла успіхи європейській економіці.*

Ключові слова: *Брексит, Великобританія, Європейський Союз, економічне зростання, інфляція, монетарна політика.*

Голоук В.Я. к.э.н., доцент кафедры менеджмента Национального технического университета Украины «Киевский политехнический институт имени Игоря Сикорского»

МОНЕТАРНАЯ СОСТАВЛЯЮЩАЯ ВЛИЯНИЯ БРЕКСИТА НА ЭКОНОМИКУ ЕС И ВЕЛИКОБРИТАНИИ

Аннотация. *Целью статьи является изучение влияния Брексита на экономический рост Великобритании и ЕС с акцентом на его монетарную составляющую. Результаты исследований показывают, что Брексит нанесет значительно больший вред экономике Великобритании, чем экономике Европейского Союза. Монетарные власти Великобритании все еще ждут решения по окончательному сценарию Брексита, оставляя денежную политику неизменной, тогда как Европейский центральный банк продолжает программу количественного смягчения, которая уже принесла успехи европейской экономике.*

Ключевые слова: *Брексит, Великобритания, Европейский Союз, экономический рост, инфляция, монетарная политика.*

Introduction. The word “Brexit” has emerged as combination of two English words: adjective “British” and noun “exit” in 2012 by model of popular at the time “Grexit”, when mass media discussed possibility of Greece leaving European institutions as a result of Greek economic crisis. Clearly, Brexit will lead to a significant change in both the UK and EU economies, the UK’s relationship with other European countries. The vast majority of studies [1] conclude that Brexit will reduce economic growth – although the scale of reduction predicted differs. ECB’s President Draghi said that the effect of the Brexit vote on the eurozone’s growth is estimated at around 0.5% over three years [2]. Long-term impact of Brexit could also vary across different types of businesses, countries, individuals. As far as numerous studies have shown positive effect of integration on European economies due to additional trade, investment and other links, we can assume that the UK economy will be smaller following Brexit than it would have been remaining the EU member.

Analysis of recent researches and publications. Numerous studies have been performed setting out a range of predictions for how Brexit is likely to affect the UK and EU economic growth. Consequences of Brexit for the UK and EU economies were researched by B. Mueller, F. Papadia, A. Stojanovic, G. Tetlow et al. Monetary aspects of Brexit were analysed by J. Mourmouras, H. Mustoe, L. Singleton. The vast majority of these studies predict that Brexit will hurt UK economy much more than economy of European Union. The largest negative impacts of Brexit are predicted by those studies, which allow reductions in trade, investment and migration to have a permanent effect on the UK's innovative activity, and so permanently reduce productivity growth. The predictions are more pessimistic for scenarios in which significant barriers to trade develop between the UK and EU [1].

Setting objectives. The goal of the study is to analyze the impact of Brexit on United Kingdom and European Union economies and to determine prospective trends of its monetary policies.

Research results. On 23 June 2016 citizens of the United Kingdom voted to leave the European Union. On 29 March 2017 the UK formally notified the European Council of its intention to leave the EU by triggering of Article 50 of the Lisbon Treaty. At the special summit on 10 April 2019 EU leaders agreed EU leaders agree to delay Brexit until 31 October [3]. If both sides ratify the withdrawal agreement between the UK and EU earlier, during these six months, the UK will leave on the first day of the following month. It means that during these six months United Kingdom can ratify the agreement and leave EU by 31 October 2019, can review its strategy on Brexit or even can cancel it. It should be noted that the President of European Council Donald Tusk assumes that the UK leaving the EU could be postponed one more time [4]. It would be positive for both European and UK business, because it gives them more time to adapt.

There are two possible ways of Brexit: “soft” and “hard”. The two terms essentially refer to the kind of relationship and level of participation the country will have with the EU's Single Market – the free movement of people, goods and services – and the Customs Union – the bloc's trade and tax agreement. Soft Brexit means that the UK could gain special access to the single market but might have to, in return, compromise on immigration agreements. Hard Brexit means taking the UK completely out of the EU – including both the single market and the customs union, so it free from its regulations and tariffs [5].

Brexit consequences for the UK are rather pessimistic. Europe is Britain's most important export market and its biggest source of foreign investment, and membership in the bloc has helped London cement its position as a global financial center. An announcement, or at least a threat of big changes, could make a lot of companies to leave Britain. The government has projected that in 15 years, the country's economy will be anywhere from 4% to 9% smaller under the Brexit, than it would inside the bloc, depending on how it leaves [6]. It is expected that the so-called “soft” Brexit would be much better for British financial markets than the “hard” one, because the last scenario would cause more political uncertainty and, as a result, higher volatility. On the contrary, soft Brexit would provide confidence and certainty, that in turn would boost economic growth and would push the UK interest rates up.

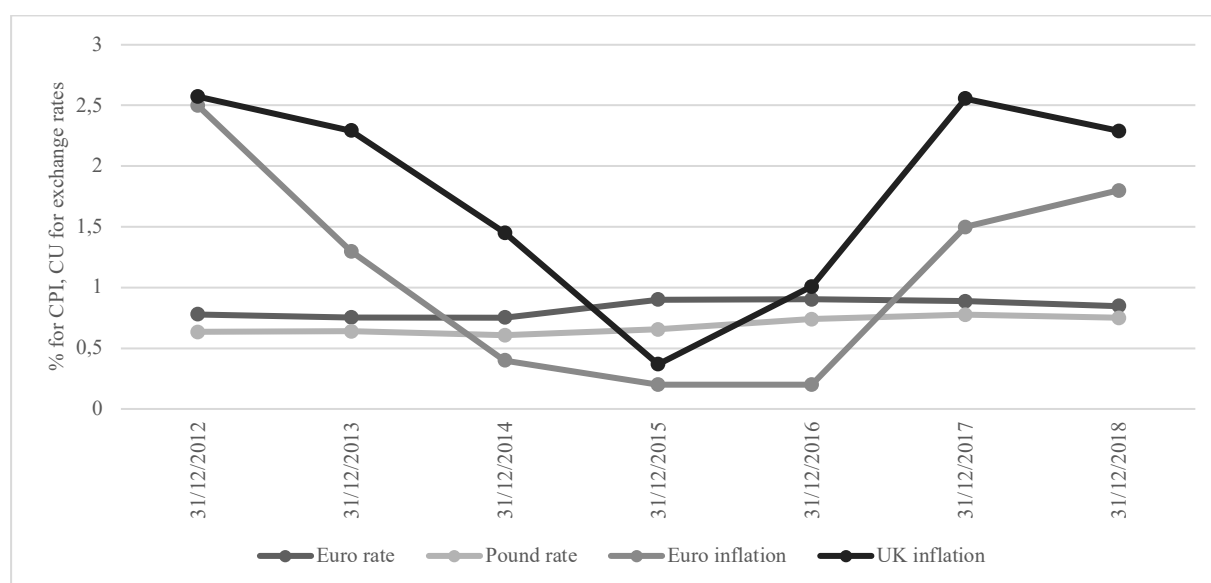


Fig. 1. Inflation, consumer prices (CPI) (annual %), official exchange rate (currency units per 1 US dollar) of Euro area and United Kingdom

Source: developed by author on the basis of [7,8].

Brexit process is also influencing the exchange rate of the UK currency. During the past two years, the pound has had a rough time of things when it comes to its price against the dollar and other currencies (see fig.1). The immediate aftermath of the Brexit referendum saw sterling decline sharply in value [9]. Just on the date of the referendum (on June 2016), sterling depreciated by nearly 7% against a basket of currencies, an extraordinarily large movement in one day, clear evidence of a shock. Subsequently the exchange rate settled at a new lower level, moving up and down within a relatively narrow corridor, mostly reflecting the flow of news about Brexit [11].

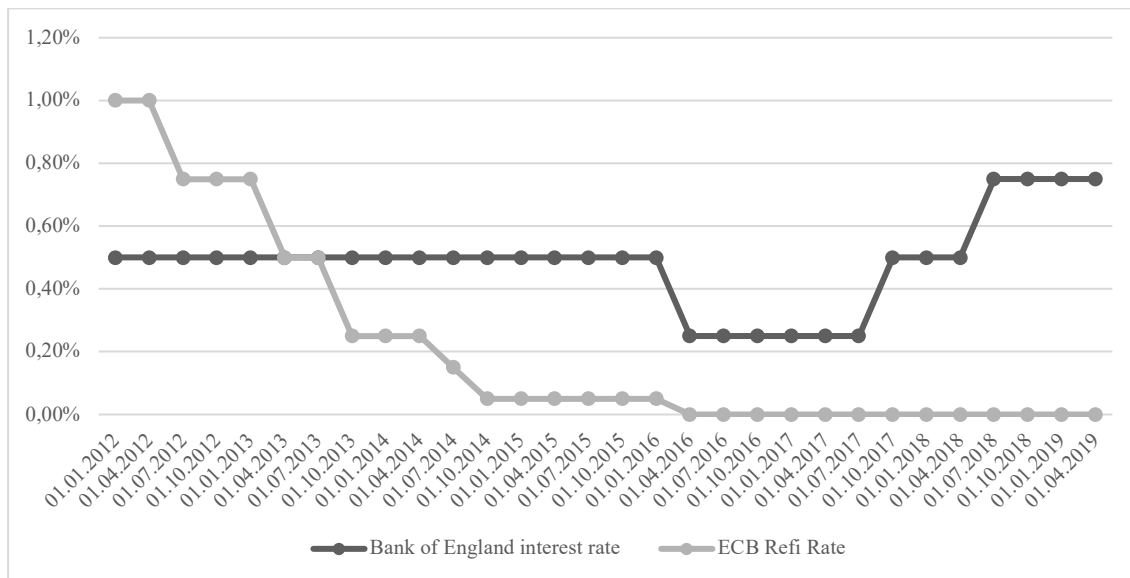


Fig. 2. Bank of England Official Interest Rate and ECB Refinancing Rate in 2012-2019.

Source: developed by author on the basis of [11,12].

Rather than do nothing, the Bank of England's Monetary Policy Committee stepped in straight after the referendum to cut interest rates (see fig.2), increase liquidity by purchasing government and corporate debt, and provide banks with access to cheap finance to help support lending to businesses and households. Governor of the Bank of England Mark Carney estimates that these actions have helped to boost economic growth by between 0.5% and 1% over the past two years [1]. The Bank of England cut the policy rate by 25 basis points (it is now 0.25%), and expanded the government bond purchase scheme by £60 billion, bringing the total to £435 billion. It also established a new corporate bond purchase program of £10 billion, and launched a new Term Funding Scheme that will provide funding for banks at rates close to the monetary policy rate [2]. Still, the uncertainty surrounding the timing and the "type of Brexit" to be implemented, given the size of the current account deficit and the uncertainty around the continuation of foreign capital inflows, poses a big risk for the pound and further depreciation is expected, albeit, at a somewhat lesser extent than originally expected. Sterling investors thus face continuing pain for the foreseeable future [2]. At the present time Bank of England delays interest rate decisions until it has a clearer picture of how the UK economy will be affected post-Brexit. Some members of the Bank of England's Monetary Policy Committee have previously suggested that rates may need to be cut in the event of a "no-deal" Brexit to boost the economy [13]. Cutting rates is rather expectable considering relatively low inflation level in the UK and the fact that the economy grew rather slow by historical norms and need to be pushed up. What is clear now, that the Old Lady's authorities [13] declare that the Bank "will always act to achieve the 2 per cent inflation target".

At the mean time ECB continues its quantitative easing programme. The asset purchase program, a monetary experiment known as QE, was launched in March 2015 to prevent sub-zero inflation from further hitting an economy still reeling from the euro zone debt crisis [14]. By the end of 2018 ECB has spent 2.6 trillion euros (\$3 trillion) over almost four years, buying up mostly government but also corporate debt, asset-backed securities and covered bonds — at a pace of 1.3 million euros a minute. That equates to roughly 7,600 euros for every person in the currency bloc. As intended, this programme has increased economic growth while wages and lending have risen but inflation remains subdued, complicating the QE exit and ensuring interest rates will stay at record lows for some time. Nevertheless ECB has also been criticized because the bond buying has depressed interest rates and hurt European banks' profitability [14].

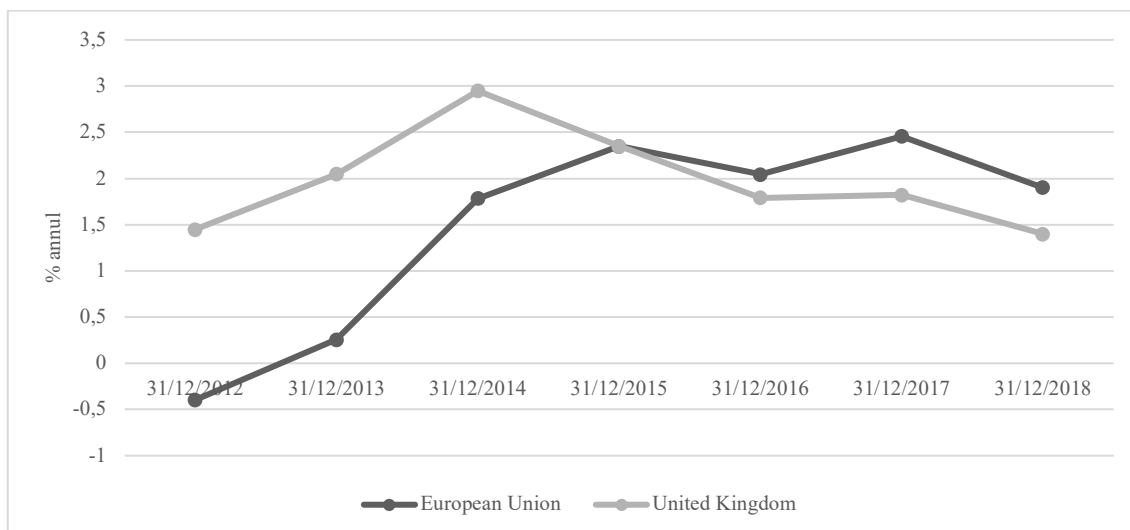


Fig. 3. Economic growth in European Union and United Kingdom in 2012-2018.

Source: developed by author on the basis of [15].

Brexit referendum results have made negative impact on the whole European economy, but the consequences for the UK are the worst. Even though the UK has not had a recession since the referendum, there is a variety of evidence that economic performance has been weaker than it probably would have been. UK – unlike in previous years – started growing at a slower rate than the euro area shortly after the referendum. In the four years before the referendum, the UK economy was growing by some 1.2% more than the euro area on average every year. *Economic models show that* if this differential had remained constant, given that more than two years have passed since the referendum and given the growth in the euro area in this period, the UK economy would now be some 4% larger than its real current size [10]. The main risks stem from the loss of market access through ‘passporting’, which is unlikely to be fully offset by any new equivalence regime or bespoke trade agreement. Some researches [1] suggest that if the UK were to trade with the EU on WTO terms, approximately £18–20bn in revenue and up to an estimated 31,000 to 35,000 jobs could be at risk, along with approximately £3–5bn of tax revenues a year. The eventual impact – and what additional barriers are imposed on the UK financial services businesses wishing to trade with the EU – will depend on the deal that is struck between the UK and EU. The Government’s latest analysis suggests [1] that non-tariff barriers to financial services trade would be relatively modest – equivalent to around a 5% tariff in a free trade agreement scenario.

While growth in the UK had decreased (see fig.3), inflation had remained higher in the UK, thus breaking the consistency between higher growth and higher inflation in the UK with respect to the euro area (see fig.1). Now Bank of England is trying to keep inflation within 2% target level and is waiting for the final decision of the UK Parliament concerning the “soft” or “hard” Brexit scenario. Level of investments in the UK has also decreased, while in EU it has grown since the Brexit Referendum.

European economy recovers at a “modest” pace, but still faster comparing to the UK. Loan growth continued to recover - across the largest euro area countries, overall terms and conditions eased across all larger countries except for Germany [2]. According to EBA consumer trends report 2018/19 [16] there has been a relatively steady increase in both the volume and the value of lending for house purchases across the EU over the past 5 years (2013-2018). The volume of consumer credit has been relatively stable for the past 5 years, with a steady growth of credit for consumption, which increased by 5.1% between 2016 and 2017 [16]. EIB Investment Report 2018/2019 addresses a moment of economic recovery in which investment growth, overall, is strong, but downside risks to the economic outlook are rising. According the report investment growth is consolidating across the EU. Measured as gross fixed capital formation, investment grew by 4% on average in 2017 and the first half of 2018. Investment rates have reached historical averages [17], apart from in the “periphery” group of countries, where investment growth is healthy but investment by households and government remains low.

Consequences of Brexit for Ukraine are also negative. A period of Brexit “uncertainty” is damaging for the both EU and the UK and so indirectly for Ukraine. Slowdown of growth in EU – Ukraine’s largest trade partner accounting for 34% of goods exports in 2015 (USD 13bn) – will dampen the prospects for

Ukraine's economic recovery, making it difficult to reach 4.0% medium-term growth forecasted by the IMF [18].

Conclusions and further research directions. The results show, that Brexit influence will vary depending on the country, type of industry and company. It's obvious that Brexit will hurt the UK economy much more than economy of European Union. Economic growth is expected in both economies, but in United Kingdom it would be weaker than it probably would have been in case of no-Brexit scenario. Consequences for European Union and especially for the UK would be much better in case of adopting the "soft" Brexit.

The UK monetary authorities keep monetary policy unchanged waiting for the decision on the Brexit final scenario, while European Central Bank continues its quantitative easing programme, that has already brought gains for European economy, witnessed by the steady growth in EU investments. Now the UK and EU monetary authorities develop different sets of measures aimed to minimize negative impact of each possible Brexit scenario. Next study will be dedicated to Brexit impact on the global economy.

References

1. Tetlow G., Stojanovic A. Understanding the economic impact of Brexit. *Institute for Government*. October 2019. URL: <https://www.instituteforgovernment.org.uk/sites/default/files/publications/2018%20IfG%20%20Brexit%20impact%20%5Bfinal%20for%20web%5D.pdf>
2. Mourmouras J. Post-Brexit effects on global monetary policy and capital markets. *Speech at an event organised by the Hellenic American Association for Professionals in Finance (HABA), New York City*. 5 October 2016. URL: <https://www.bis.org/review/r161216g.pdf>
3. Brexit. *European Union official web-site*. URL: https://europa.eu/european-union/about-eu/countries/member-countries/unitedkingdom_en#brexit (retrieving data – 08.06.2019)
4. Вендик Ю. «Брексит» отложен до 31 октября: ЕС дал Британии длинную отсрочку. *Русская служба Би-би-си*. 11 апреля 2019. URL: <https://www.bbc.com/russian/news-47887922>
5. Chaplain C. What do 'hard Brexit' and 'soft Brexit' mean and what is the difference between them? *I-News*. November 26, 2018. URL: <https://inews.co.uk/news/brexit/hard-brexit-vs-soft-brexit-difference-meaning-what-consequences/>
6. Mueller B. What Is Brexit? A Simple Guide to Why It Matters and What Happens Next. *The New York Times*. May 24, 2019. URL: <https://www.nytimes.com/interactive/2019/world/europe/what-is-brexit.html>
7. Yearly Average Rates. *OFX*. URL: <https://www.ofx.com/en-au/forex-news/historical-exchange-rates/yearly-average-rates/> (retrieving data – 08.06.2019)
8. Inflation. *OECD official web-site*. URL: <https://data.oecd.org/price/inflation-cpi.htm> (retrieving data – 08.06.2019)
9. Mustoe H. How does Brexit affect the pound? *BBC News*. 15 January 2019. URL: <https://www.bbc.com/news/business-46862790>
10. Papadia F. The shadow of Brexit: Guessing the economic damage to the UK. *Money matters? Perspectives on Monetary Policy*. March 27, 2019. URL: <http://moneymatters-monetarypolicy.eu/the-shadow-of-brexit-guessing-the-economic-damage-to-the-uk/>
11. Interest rates of European Central Bank. *Global Rates*. URL: <https://www.global-rates.com/interest-rates/central-banks/european-central-bank/ecb-interest-rate.aspx> (retrieving data – 08.06.2019)
12. Interest rates of Bank of England. *Global Rates*. URL: <https://www.global-rates.com/interest-rates/central-banks/central-bank-england/boe-interest-rate.aspx> (retrieving data – 08.06.2019)
13. Singleton L. Bank of England to adopt wait and see approach as Brexit unfolds. *Imperial College News*. March 11, 2019. URL: <https://www.imperial.ac.uk/news/190515/bank-england-adopt-wait-approach-brexit/>
14. Carvalho R., Ranasinghe D., Wilkes T. The life and times of ECB quantitative easing, 2015-18. *Reuters*. December 12, 2018. URL: <https://www.reuters.com/article/us-eurozone-ecb-qe/the-life-and-times-of-ecb-quantitative-easing-2015-18-idUSKBN1OB1SM>
15. Economic growth, % annual. *World Data Atlas, Knoema. World development indicators (2018)*. URL: <https://knoema.com/WBWDI2019Jan/world-development-indicators-wdi> (retrieving data – 08.06.2019)
16. Consumer Trends Report 2018-2019. *European Banking Authority*. 2019. URL: <https://eba.europa.eu/documents/10180/2551996/Consumer+Trends+Report+2018-19.pdf>
17. EIB Investment Report 2018/2019: retooling Europe's economy - Key findings. *European Investment Bank*. 2019. URL: https://www.eib.org/attachments/efs/economic_investment_report_2018_key_findings_en.pdf
18. Bilan O. Brexit: Shall Ukrainians Worry. *Wox Ukraine*. June 21, 2016. URL: <https://voxukraine.org/en/brexit-shall-ukrainians-worry-en/>